

Bond Capacity Alternatives

The debt limit is a consideration in capital budgeting

The amount of state bonds that can be issued in any year is limited by a constitutional debt limit and a statutory debt limit. The annual debt service (principal and interest payments) on outstanding bonds cannot exceed 9% of the three year average of general state revenues under the constitution and 7% under the statutory limit. When writing capital budgets, the legislature considers debt capacity to ensure the debt limit does not become an issue in implementing capital budgets. Bonds are issued over the four or more years it typically takes to design and construct a major project, so the legislature must plan for bond capacity for several years into the future.

Bond capacity increased in the 2003 Session

In the last several years, a capital budget proposal like the Governor's 2004 supplemental budget proposal that required a bond bill to fund new appropriations would raise the question regarding whether sufficient bond capacity under the 7% statutory debt limit exists. HB 2242 in 2003 increased bond capacity by adding property taxes to the definition of general state revenues, effectively making the 7% limit the same as the higher 9% constitutional debt limit. The proposed 2004 bond bill would cause the debt service percentage of general state revenues to grow slightly to average about 8.5% over the next several years. If the Legislature decides to agree with the Governor and pass a 2004 bond bill, the impact on debt capacity will be at the margins since the amount likely will be small in relative terms. However, the 2004 bond bill decisions will be made in the context of a potentially much more difficult and challenging decision regarding the 2005-07 capital budget a year from now.

Despite capacity increase, decisions/challenges remain

The conferees' plan in developing the final 2003-05 capital budget was to adopt a base capital budget, excluding Gardner-Evans, of about \$1.2 billion for 2003-05 to accommodate the 768-bed prison expansion at the Penitentiary in Walla Walla and other items, then go back to a base of about \$1 billion to stay within a working debt limit of 8.5% (except for the 2007 pinch point). In that regard, the Gardner-Evans bond proposal was reduced from \$1 billion to \$750 million to accommodate the Transportation bonds and stay within the 8.5% working limit. To stay within an 8.5% working debt limit in 2005-07 will require a base bond-financed capital budget of about \$1 billion, a decrease in the 2003-05 base budget of \$180 million and a decrease of \$250 million if the Governor's 2004 proposed supplemental budget level is included.

To maintain an 8.5% working debt limit, the challenge in 2005-07 will be similar to the 2003-05 budget before the Gardner-Evans proposal facilitated legislation to increase bond capacity. The 2003-05 budget included a large prison expansion and used bonds to help fund K-12 construction assistance. In the base bond-financed budget under an 8.5% working debt limit of \$1 billion in 2005-07 (excluding Gardner-Evans), \$90 million could go to expanding Coyote Ridge and \$130 million for K-12 construction, leaving \$780 million for the rest of the capital budget. This compares to \$966 million in 2001-03 for the rest of the budget and about \$950 million in 2003-05. This is illustrated as follows (\$ in millions):

	<u>01-03</u>	<u>03-05</u>	<u>03-05 (Gov Supp)</u>	<u>05-07</u>
Base*	966	930	955	780
Prison**	0	130	175	90
K-12	<u>0</u>	<u>120</u>	<u>120</u>	<u>130</u>
Total	966	1,180	1,250	1,000

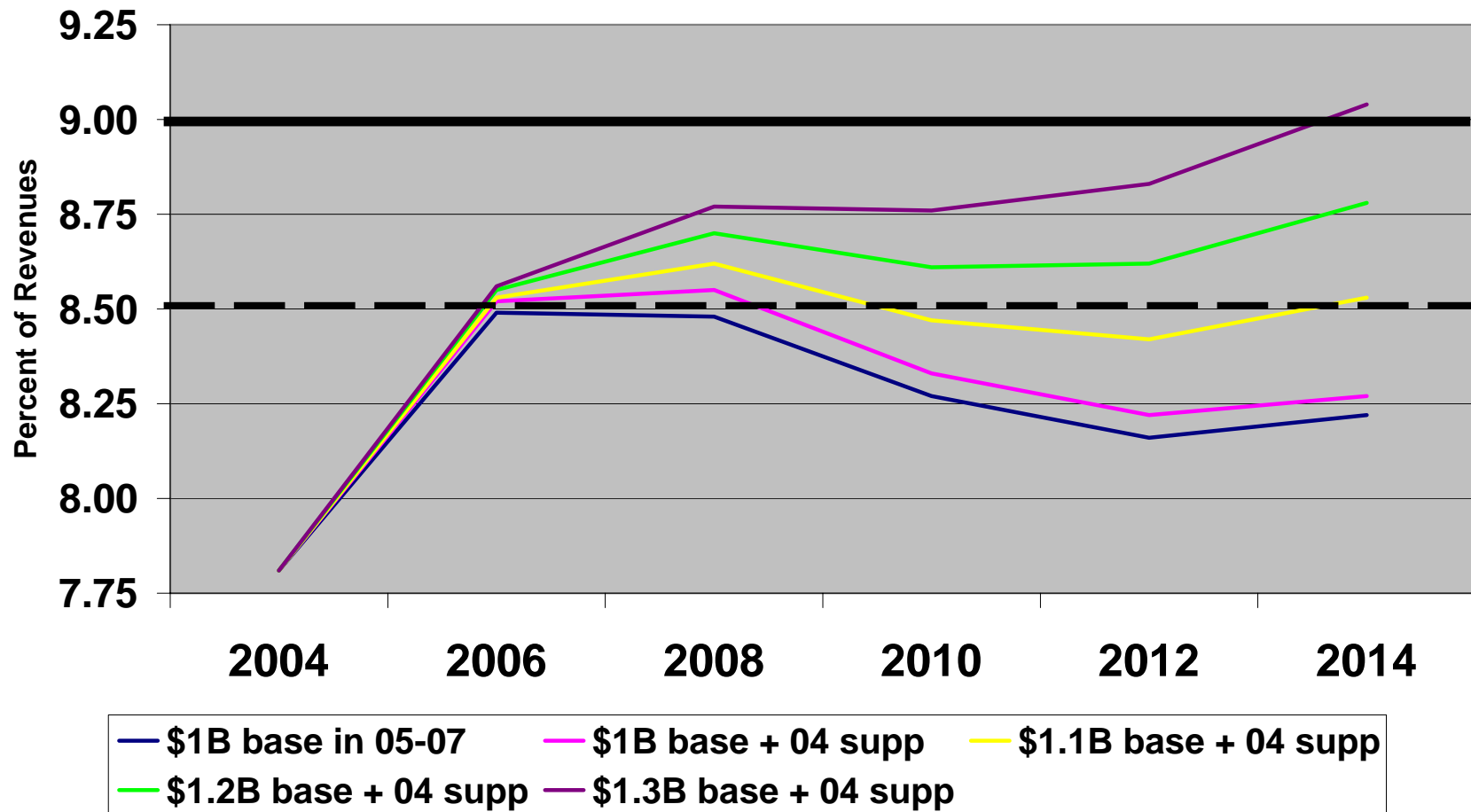
* This is the bond-financed base without Gardner-Evans, prison expansion, or K-12.

** The penitentiary in 2003-05, Coyote Ridge in the 2004 supplemental and 2005-07.

Should the Legislature choose to revisit the 8.5% limit for 2005-07, it could consider a variety of alternatives; a few are illustrated in the enclosed chart. For example, a base bond-financed capital budget of \$1.2 billion instead of \$1 billion starting in 2005-07 results in a debt service percentage that is between 8.5% and 8.75% until reaching 8.75% in 2014 based on current assumptions. In deciding on whether to stick to the working debt limit, key considerations could include the substantial fiscal problems that will occur if the state reaches the 9% limit for any length of time, and how much of a cushion or reserve should there be to accommodate emergencies/disasters, unforeseen events, and higher interest rates or reduced revenues. An example of a potential unforeseen event is the recent discussion on guaranteed leases. While there is widespread agreement that guaranteed leases generally are not debt, had the analysis of this question turned out differently and these leases be considered debt by the Treasurer, most of the current available debt capacity would be gone and the state would be much closer to the 9% limit now.

Debt Limit Comparisons

(Estimated using 2005-07 base budget)



Note: The base budget is bond-financed appropriations excluding Gardner-Evans and transportation bonds.
The Constitutional debt limit is 9.0%. A working debt limit of 8.5% was agreed on in 2003.